

STATE CONTROLLER'S OFFICE  
PERSONNEL/PAYROLL SERVICES DIVISION  
P.O. Box 942850  
Sacramento, CA 94250-5878

DATE: June 26, 2003

PAYROLL LETTER # 03-009

TO: All Agencies/Campuses in the Uniform State Payroll System

FROM: JOHN R. HARRIGAN, Chief  
Personnel/Payroll Services Division

RE: **INTERNAL REVENUE SERVICE (IRS) COMPLIANCE ACTIVITIES**

This Payroll Letter provides information regarding IRS compliance activities for 2003/04 impacting employer employment tax and reporting.

#### COMPLIANCE OVERVIEW

As noted in prior Payroll Letters, a major IRS reorganization in 2000/01 produced a structure for the first time, wherein the nation's 85,000 public employers are uniquely identified. The IRS dedicated one new division to provide services and perform tax compliance functions exclusively for public sector employers. The Federal, State and Local Government (FSLG) Division's primary roles include outreach training, client liaison, and compliance activities for over 50 tax based areas. These areas include employment tax issues, fringe benefits/employee business expenses, Forms W-2/1099 reporting, resident and non-resident aliens reporting, worker classifications, etc.

The FSLG Division announced a compliance program for its clients--Federal, State and Local Government employers. Compliance activities now underway entail the IRS conducting compliance checks, compliance reviews and examinations (audits). FSLG estimates that 75-80% of its 2003/04 resources will perform compliance activities. The following highlights each compliance activity.

**COMPLIANCE CHECK**--is a review conducted by the IRS under Title 26 of the Internal Revenue Code (IRC) to determine whether a governmental entity is adhering to record keeping and information reporting requirements. A compliance check does not directly relate to the determination of a tax liability for any particular period. IRS will review an employer's activities and request the employer to voluntarily file documents or IRS may file substitute documents. IRS may opt to initiate an examination. IRS may conduct compliance checks as often as facts and circumstances warrant.

**COMPLIANCE REVIEW**--is a review conducted by the IRS under IRC 7602 to determine whether an entity is meeting its record keeping and reporting requirements. IRS examiners must inspect books, records, etc. of the entity to make a proper determination. The IRS may decide at any time during the review that an examination/audit is appropriate. If so, the IRS specialist will notify the entity that it is commencing an examination/audit.

**EXAMINATION**--is an intensive audit conducted by the IRS under IRC 7602 entailing a detailed inspection of an entity's books and records. The examination involves the questioning of witnesses to determine an entity's correct tax liability. The IRS will ask entities about their business practices, policies and why they treat expenses or tax issues a certain way. Examinations are complex and based upon facts and circumstances.

#### NOTIFICATION PROCESS

Generally, a governmental entity will be notified by phone to set up an appointment time and wherein the IRS specialist will outline which of the three compliance initiatives will be conducted. A letter will follow reaffirming

the appointment time, outlining what information or records to have available, and explaining the employer's (systemwide employer/local employer/reporting agent) rights during the process.

#### CONTACTS

Questions regarding IRS compliance notifications should be directed to your local FSLG Specialist or to the Pacific Coast FSLG Area Office, Mr. Garrett Rigoni at (925) 279-4011, Ext. 204). For general employment tax questions, please use the IRS toll-free Governmental Entities Customer Assistance number, (877) 829-5500.

Should IRS contact your agency regarding tax compliance activity (excluding Form 1099 reporting) related to employment tax matters for employees paid via the Uniform State Payroll System, please contact the Tax Support Section at (916) 323-4923 or (916) 322-8105.

JRH:DB/TSS